

**ORIGINAL**

April 23, 1998

EX PARTE OR LATE FILED

Ms. Magalie Roman Salas  
Secretary  
Federal Communications Commission  
1919 M Street, N.W.  
Washington, D.C. 20554

**RECEIVED**

APR 23 1998

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Re: CC Docket Nos. 96-45 and 80-286

Dear Ms. Salas:

On behalf of the Rural Telephone Coalition (RTC), this filing reports that a letter like the example attached to this ex parte report is being mailed to all state public utilities commissioners. Since those addressees include members of the two above-referenced federal state joint boards and the letter relates to universal service and jurisdictional separations issues pending before the joint boards or the Commission, the RTC is submitting the letter as a written ex parte presentation.

The RTC is filing two copies of this letter and the attachment for inclusion in the ex parte file for each of the referenced proceedings.

In the event of any questions about this submission, please let me know.

Very truly yours,

*Margot Smiley Humphrey*  
Margot Smiley Humphrey

*051*

**NRTA**

NATIONAL RURAL TELECOM ASSOCIATION  
1 Massachusetts Ave., NW  
Suite 800  
Washington, D.C. 20001  
(202) 628-0210

**NCTA**

NATIONAL TELEPHONE COOPERATIVE  
ASSOCIATION  
2626 Pennsylvania Ave., NW  
Washington, D.C. 20037  
(202) 298-2300

**OPASTCO**

ORGANIZATION FOR THE PROMOTION  
AND ADVANCEMENT OF  
SMALL TELECOMMUNICATIONS COMPANIES  
21 Dupont Circle NW, Suite 700  
Washington, D.C. 20036  
(202) 659-5990

# T H E   R U R A L   T E L E P H O N E   C O A L I T I O N

April 23, 1998

Mr. Hulihan Williams Moore  
Chairman  
Virginia State Corporation Commission  
Tyler Building, PO Box 1197  
Richmond, Virginia 23218

Dear Chairman Moore:

The Rural Telephone Coalition (RTC) is deeply concerned: The ongoing debate about support for nationwide universal service appears to have shifted away from the principles enacted by Congress in the Telecommunications Act of 1996. That shift is caused in part by the attention being given to the Ad Hoc plan discussed later in this letter, differing views among state regulators about the impact of universal service proposals and the overlapping issues before the separate Federal-State Joint Boards implementing the universal service provisions and reforming the jurisdictional separations process. The RTC urges regulators in all states and at the FCC to avoid the prolonged uncertainty about support flows, congressional oversight and litigation that would result from failure to follow the Act as Congress passed it or failure to coordinate the actions of the two joint boards charged with representing legitimate state interests in implementing national universal service mechanisms and drawing state and interstate cost recovery boundaries.

The RTC is comprised of three associations, the National Rural Telecom Association (NRTA), the National Telephone Cooperative Association (NTCA) and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO). Our members include more than 850 primarily small and rural local exchange carriers (LECs) that fulfill universal service responsibilities for about 5 million rural subscribers. The low density communities our members serve typically have high unit costs because economies of scale are inherently limited where traffic volumes are low and the customer base is small.

Rural consumers have been served well by past mechanisms providing rural LECs enough high cost support to furnish affordable and up-to-date services and network capabilities. The RTC was an active participant in the legislative process that led the 1996 Act to codify and further spell out the nation's commitment to "sufficient," "predictable" and "specific" federal high cost support to prevent our rural customers' rates, services and access to evolving telecommunications opportunities from falling behind metropolitan telecommunications progress. That process never involved or contemplated a support system that pits consumers in rural states against those in urban states. Instead, the expanded principles in Section 254 built on and retained the Section 1 goal of a "Nation-wide" system available "to all people in the United States...."

## NRTA

**NATIONAL RURAL TELECOM ASSOCIATION**  
1 Massachusetts Ave., NW  
Suite 800  
Washington, D.C. 20001  
(202) 628-0210



**NATIONAL TELEPHONE COOPERATIVE  
ASSOCIATION**  
2626 Pennsylvania Ave., NW  
Washington, D.C. 20037  
(202) 298-2300

## OPASTCO

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21 Dupont Circle NW, Suite 700  
Washington, D.C. 20036  
(202) 659-5990

Rural telephone companies and their customers have a particularly keen interest in full implementation of the national policy commitment to affordable, reasonably comparable rural and urban rates, services and access to advanced telecommunications and information services for all Americans. These nationwide universal service principles, prescribed by Congress in §254, mandate nationwide federal support and contribution mechanisms to enable consumers in all parts of the nation to share in the direct and indirect or “external” benefits of an information-rich society and economy by having access to a universally available, affordable and advancing public telecommunications network. Close cooperation among all states and particularly those states chosen to represent all the state regulators by serving on the universal service and related separations Joint Board is essential to ensure that all consumers in all states enjoy the benefits Congress intended.

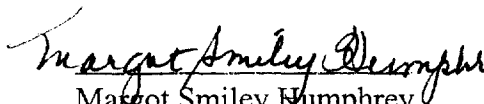
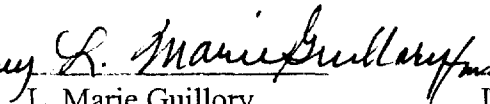
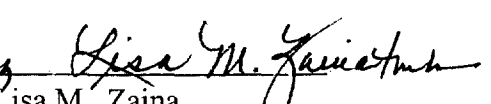
The universal service decisions made last year require significant modifications to deliver on the directives in the legislation. As explained in the attached memorandum, the RTC urges the FCC, the Joint Boards, NARUC and all state commissioners, in their consensus building efforts and subsequent determinations:

1. To jettison the unlawful 25% federal support allocation;
2. To provide sufficient, predictable and specific federal universal service support to satisfy the mandates of §254;
3. To reach decisions that achieve the statutory goals of the federal support programs throughout the nation, while refraining from substituting an unwarranted and spurious state “inflow” or “outflow” criterion in the statutory requirements.
4. To provide for “sufficient” “predictable” and “specific” federal support and allocate carrier contributions equitably through lawful jurisdictional separations of investment, expenses and revenues; and
5. To coordinate the universal service and separations decisions carefully to achieve the universal service mandates in section 254 and maintain the proper boundaries of federal and state jurisdiction.

The RTC would welcome the opportunity to discuss these legal conclusions with you or your staff. We look forward to fruitful state and federal cooperation in tailoring a lawful and sustainable federal universal service program to foster a competitive telecommunications environment, while meeting the needs of customers in high cost parts of the nation.

Sincerely,

THE RURAL TELEPHONE COALITION

 Margot Smiley Humphrey Counsel for NRTA Koteen & Naftalin, L.L.P. 1150 Connecticut Ave., NW Suite 1000 Washington, D.C. 20036	 L. Marie Guillory Vice President, Legal and Industry NTCA 2626 Pennsylvania Ave., NW Washington, D.C. 20037	 Lisa M. Zaina Vice President and General Counsel OPASTCO 21 Dupont Circle, NW Suite 700 Washington, D.C. 20036
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Enclosure

## Memorandum

To: State Commissioners  
From: The Rural Telephone Coalition  
Re: Achieving National Universal Service Policy Requires "Sufficient" Nationwide Support

### Sharing the Costs of a Nationwide Public Network — -Pre-1996

The key to the nation's successful universal service policy has been and remains the ability to recover enough of the high costs of rural service and discounted low income services from a nationwide customer base. For many years, the jurisdictional separations process has played a key role in maintaining reasonable rural rate and service parity throughout the nation. Tapping a nationwide support base by interstate cost allocations spreads the heavy rural cost burdens inherent in serving a limited number of rural residents and businesses, sparsely settled territory and limited traffic volumes. What would be hundreds of dollars collected from some individual customers on a stand-alone basis could be shared by all interstate ratepayers for a few pennies a month.

Before the AT&T divestiture and the advent of access charges, the nationwide support function took place through the nationwide "partnership" among the Independent local exchange carriers (LECs) and the Bell system. AT&T set its interstate rates under a nationwide schedule designed to recoup all carriers' interstate costs, including a reasonable rate of return. With access charges, the support flows from jurisdictional allocations were made more explicit.

Courts have long recognized that dividing ratemaking authority for using the same network between state and interstate regulators involves public policy rather than economics.<sup>1</sup> Hence, regulators have lawfully earmarked a substantial share of high rural service costs for interstate cost recovery. This, in turn, (a) spread the duty to compensate providers of high cost public network segments over more than 158.6 million interstate access lines by the end of 1996 and (b) ensured that the costs left for recovery via local rates paid by individual high cost rural customers or the limited customer base in rural areas or rural states were affordable to "the average subscriber."<sup>2</sup> The nationwide cost-sharing process has allowed public switched network

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<sup>1</sup> Rural Telephone Coalition v. FCC, 838 F. 2d 1307, 1314 (D.C. Cir. 1988) (RTC v. FCC), quoting MCI Telecommunications Corp. v. FCC, 675 F. 2d 408, 416 (D.C. Cir. 1982): " '[T]here is no purely economic method of allocation ... elements of fairness and other noneconomic values inevitably enter the analysis of the choice to be made.' "

<sup>2</sup> See, RTC v. FCC at 1315.

connections by an average of more than 90% of the nation's households and businesses.<sup>3</sup> Adequate nationwide cost recovery has also enabled rural telephone companies to provide modern telecommunications networks and services to the rural communities they serve.

### Proposals to Dismember the Statutory Nationwide Universal Service Responsibility

The 1996 Act codifies the nationwide responsibility for universal service support. It expressly requires (a) "Federal universal service support" that is "sufficient to achieve the purposes of this section [§254]" and (b) "equitable and nondiscriminatory" contributions obtained from providers of interstate services to fund the "sufficient" federal universal service support mechanisms. The Universal Service Joint Board, with state commission representation, affirmed these principles and defined the largely local services to be supported by federal mechanisms without recommending that any portion of the federal mechanism was the responsibility of the states. Unfortunately, however, starting with the FCC's arbitrary unilateral decision on May 8, 1997 to limit federal support to 25% of what is necessary for nationwide realization of the national universal service definition, the nationwide cost recovery focus has been deflected: Debate on how to keep the statute's promise to consumers has been overshadowed by state-versus-federal and state-versus-state sparring about whose constituents will "win" or "lose" from the federal cost-spreading mechanisms. When a few states substituted a state-by-state perspective for the nationwide federal mechanism Congress had forged by balancing many interests — including those of state regulators — an Ad Hoc group of state commissioners and their staff members submitted a high cost support plan to the FCC to balance the interests of "high cost" and "low cost" states. One of their goals in this balancing is to avoid litigation between the states and the FCC. Their goals also accede to the FCC's reluctance to increase high cost support beyond the existing illegally capped amount, despite the statutory mandates for "sufficient" federal support affordable rates and "reasonably comparable" rural and urban rates and services throughout the nation.

The Ad Hoc group's intention to obtain state consensus on high cost support is laudable. But the law requires strict adherence to the statutory standards, undiluted by the supposed interest of individual states in controlling the aggregate contribution to federal universal support mechanisms by their citizens. Such states recast the federal universal service mechanism as a net state out- or inflow of contributions for the high cost mechanism alone. But that view undermines the Act's prescribed vehicle — a federal cost recovery program to spread high cost support that deliberately transcends state boundaries to achieve nationwide comparability as well as nationwide delivery of affordable federally-defined universal services. It makes as little sense to calculate "state" support flows for this network-wide cost recovery as it would to attack the system of federal support for national parks as a national resource because the cost absorbed by payers of federal taxes in a state and the support received for parks within a state's boundaries differ from state to state. A consensus decision based on a standard foreign to the list in §254 —

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<sup>3</sup> Increasing interexchange competition and deregulation of competitors, however, allowed some providers to avoid imposing a fair share of the nationwide support responsibility on their customers. Thus, Congress adopted §254(d) to ensure that all interstate carriers and customers participated in the nationwide high cost recovery process..

such as the unilateral decision of an almost entirely replaced FCC to saddle the states with 75% of the federal support or any plan based on some spurious state impact calculus — would shortchange customers that are denied sufficient federal support and would merit judicial reversal.

### State Impact Is in the Eye of the Beholder

In any event, state impact analysis is unavoidably subjective. For example, the Ad Hoc group's approach has already been criticized by other rural states which perceive the Ad Hoc proposal as freezing or reducing the flow of nationwide high cost support for local rates in their states to provide more high cost support for the Ad Hoc proponents' states. The truth is that any state can suggest an alternative that will better channel support "inflows" to its high cost areas or better shield it from the specter of net state contribution "outflows." However, the purpose of the federal high cost support mechanism is to provide affordable rates and reasonable nationwide parity in services, rates and advancements for consumers, not to balance imagined flows between states.

### Further Inroads on State Autonomy

FCC Chairman Kennard built upon the principles the Ad Hoc group articulated in their proposal to reconcile low and high cost states in his February 9 speech to NASUCA. However, his Eight Point, all-or-nothing list oversteps the statutory boundaries of federal authority. It would condition federal compliance with the §254 universal service dictates upon State actions that are not required or even authorized by the 1996 Act or intent of Congress. For example, he casts federal support as a safety net that is available to supplement state programs (1) only to the extent each state cannot take care of its high service costs by intrastate support mechanisms and (2) only if states have made all intrastate implicit support explicit — a requirement enacted for the federal mechanism in §154(e) but not applied by Congress to state mechanisms.<sup>4</sup> The states do not need the FCC to dictate their price structures or universal service obligations, especially when Congress enacted a universal service system that imposes the primary responsibility for universal service under a federal definition on a federal mechanism and simply allows states to adopt optional, self-supporting, supplemental and consistent state mechanisms (§254(f)).

### Separations as a Time Tested Tool for Explicit Nationwide Universal Service Support

The RTC does not agree with some state regulators that the §254 Joint Board and FCC lack authority to apportion the contributions for the federal high cost support mechanism among providers of interstate services on the basis of their total, rather than solely their interstate revenues. In fact, the RTC supports that approach as lawful, equitable and least likely to distort marketplace forces. The lawful way to accomplish this result is to keep universal service as part

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<sup>4</sup> Indeed, earlier legislative drafts had expressly required state and federal support to be made "explicit," but the law that was enacted dropped many of the directives earlier versions would have applied to the states, including this one.

of the jurisdictional separations process. The universal service issue of what share is a federal responsibility is, after all, simply another face of jurisdictional separations. *Smith v. Illinois Bell* established the legal and constitutional need to divide “investment, expenses and revenues” [check the quotation] between the interstate and intrastate jurisdictions as the necessary concomitant of dual rate authority.

The Communications Act recognizes that dual authority in the area of universal service and provides a vehicle for federal and state participation in decisions on funding what amounts to a federally-defined list of universal local services. The §254 Joint Board is defined in the statute as a §410(c) joint board (with an added state consumer representative). Section 410(c) establishes the statutory requirement to use a separations joint board in conducting a rulemaking proceeding involving jurisdictional allocations. Thus, Congress recognized that universal service reform involves separations and conferred appropriate authority to modify separations on the universal service joint board.

The transitional support mechanism that remains in force for rural telephone companies measures high loop costs by comparing each company’s total, unseparated loop costs to the national average total, unseparated costs and assigns some of the difference for interstate cost recovery by an “expense adjustment.”<sup>5</sup> The new methodology the FCC adopted in the May 8 order will (a) use a model to estimate the total, unseparated costs of providing universal service, (b) calculate a benchmark level of revenues that include both interstate and intrastate revenues and (c) assign the excess for recovery via the federal universal service support mechanism. Simple symmetry would suggest that contributions should also be apportioned on the basis of total, unseparated revenues in both mechanisms. If the separations process is used, contributions to the federal mechanism could be defined and calculated as a specified share of total, unseparated end user revenues.

There is another independent reason to maintain jurisdictional separations as the vehicle to effectuate sufficient cost sharing across state boundaries to satisfy the Act’s mandates for federal universal service support. As noted earlier, allocations of costs between the interstate and intrastate jurisdictions have survived judicial challenge in the past, including claims that the process amounts to an unlawful tax. Given the efforts of some parties to thwart the intent of Congress in enacting §254 by resurrecting the mistaken tax contention<sup>6</sup> and the valid arguments by others that the FCC’s 25% federal share ruling, never placed before the Joint Board, constitutes an unlawful separations modification,<sup>7</sup> it would be prudent for the Joint Board and the FCC to effectuate explicit federal high cost support through separations, consistent with lawful past practice exemplified by the USF expense adjustment.

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<sup>5</sup> 47 C.F.R. §36.601(a).

<sup>6</sup> Brief of \_\_\_\_\_, filed \_\_\_\_\_, *Texas Office of Public Utility Counsel v. FCC*, No. 97-60421 (5<sup>th</sup> Cir. 1997).

<sup>7</sup> *Petition for Reconsideration and Clarification of the Rural Telephone Coalition*, p. 9.



### Cooperation to Harmonize Universal Service and Separations Reforms

The division between the Universal Service Joint Board and the Separations Joint Board is elusive, at best. There have been arguments that the 25% federal share decision could only lawfully be adopted by a specific separations joint board proceeding. If this decision is not abandoned, the risk of judicial intervention in the universal service determinations is likely to increase.

Of greater concern to the RTC, however, is the inextricable linkage between jurisdictional separations and the share of universal service support recovered from a nationwide customer base. Unless this linkage is explicitly considered, the work of either Joint Board could undercut the balance achieved by the other. Accordingly, close coordination or perhaps even combined deliberation is essential to achieving the universal service principles enacted in Section 254.

### Conclusion

For all these reasons, the RTC urges the FCC, the Joint Board, NARUC and the state commissioners, in their consensus building efforts and subsequent determinations:

1. To jettison the unlawful 25% federal support allocation;
2. To provide sufficient, predictable and specific federal universal service support to satisfy the mandates of §254;
3. To refrain from injecting or substituting an unwarranted and spurious state “inflow” or “outflow” criterion in the statutory requirements for a nationwide federal universal service program;
4. To provide for “sufficient” “predictable” and “specific” federal support and allocate carrier contributions equitably through lawful jurisdictional separations of investment, expenses and revenues; and
5. To coordinate universal service and separations policy to ensure that the resulting regulatory framework achieves the universal service mandates in section 254 and maintains the proper boundaries of federal and state jurisdiction.